

MULTIMEDIA



UNIVERSITY

STUDENT ID NO

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MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 3, 2017/2018

BAC3624 – ADVANCED AUDITING
(All sections / Groups)

06 JUNE 2018
9 a.m. - 12 p.m.
(3 Hours)

INSTRUCTIONS TO STUDENTS

2. This Question paper consists of 5 pages excluding cover page with 5 Questions only.
3. Attempt all **FIVE** questions. All questions carry equal marks and the distribution of the marks for each question is given.
3. Please write all your answers in the Answer Booklet provided.

Question 1

Ethics can be defined as a set of moral principles or values while ethical dilemma is a situation a person faces in which a decision must be made about the appropriate behaviour.

- (a) Explain the six core ethical values that are associated with ethical behaviour. (6 marks)
- (b) Describe a short case which deals with ethical issues. (5 marks)
- (c) Using the six-step approach to resolve the ethical dilemmas, evaluate the case you have provided in (b) above. (9 marks)

(Total : 20 marks)

Question 2

- (a) Determine six factors that have affected the incidence of lawsuits against auditors in the recent years. (6 marks)
- (b) Explain how an engagement letter could affect an auditor's liability to clients under common law? (3 marks)
- (c) Mutu & Co was engaged to audit Auto Supplies Sdn Bhd. Several staff were involved in the audit whereby all these staff have attended in-house audit training programs on how to conduct effective auditing methods. During the audit, Mutu spent most of his time planning the audit, supervising the staff and reviewing their work. A significant part of the audit involved verifying the physical count, cost and summarization of inventory. Inventory was highly significant to the financial statements and Mutu knew the inventory was pledged as collateral for a large loan to April Bank. Upon reviewing Auto Supplies' inventory count procedures, Mutu told the Managing Director (MD) that he believed the method of counting inventory at different locations on different days was highly undesirable. The MD stated it was impractical to count all inventory on the same day because of personnel shortages and customer preference.

After several discussions, Mutu agreed to allow the practice if the MD would sign a statement that no other method was practical. The audit firm had at least one person at each site to audit the inventory count procedures and actual count. There were more than 50 locations. One year later, Mutu found out that Auto Supplies' management had conspired to materially overstate inventory as a means of covering up obsolete inventory and inventory losses resulting from mismanagement.

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The misstatement occurred by physically transporting inventory at night to other locations after it had been counted in a given location. The accounting records were inadequate to uncover these illegal transfers. Both Auto Supplies Sdn Bhd and April Bank sued Mutu & Co.

Required:

- i) Explain the defense that Mutu & Co should use in the suit by Auto Supplies Sdn Bhd. (3 marks)
- ii) Explain the defense that Mutu & Co should use in the suit by April Bank. (4 marks)
- iii) Is Mutu likely to be successful in his defense? Explain. (4 marks)

(Total : 20 marks)

Question 3

Ali is a senior auditor with vast experience doing IT audit. Ali has been asked by the audit partner to conduct audit in ABC Berhad's database system. Ali's preliminary understanding of the database system includes the following points:

- 1. There are no restrictions regarding the type of transaction or access to the online terminals.
- 2. All users and IT personnel have access to the extensive system documentation.
- 3. Before being entered into the user authorisation table, user passwords and access codes are established by user management and approved by the manager of computer programming.
- 4. The manager of computer programming established and controls the database directory. Users approve any changes in data definition.
- 5. User requests for data are validated by the system against a transactions-conflict matrix to ensure that data is transmitted only to authorised users.
- 6. System access requires the users to input their passwords, and terminal activity logs are maintained.
- 7. Input data are edited for reasonableness and completeness, transaction control totals are generated, and transaction logs are maintained.
- 8. Processing control totals are generated and reconciled to changes in the database.
- 9. Output is reconciled to transaction and input control totals. The resulting reports are printed and placed in a bin outside the IT room for pickup by the users at their convenience.
- 10. Backup copies of the database are generated daily and stored in the file library area, access to which is restricted to IT personnel.

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Required:

- a) From the results of your preliminary review, explain five controls in the system.
(5 marks)
- b) List and briefly explain five specific audit steps you would include in your audit programme to determine whether the transaction input is properly authorised.
(10 marks)
- c) Evaluate the relative strengths of the general and application controls for the database system.
(5 marks)

(Total : 20 marks)

Question 4

Bliz Sdn Bhd (Bliz) manufactures hand gloves and has three factories, four warehouses and two depots across Malaysia. The audit for the year ended 31 December 2017 is almost complete and the financial statements and audit report are due to be signed shortly. Profit before taxation is RM8.9 million. The following events have occurred subsequent to the year end and no amendments or disclosures have been made in the financial statements.

Event 1 – Flood

On 15 February 2018, a flood occurred at the largest of the distribution depots. The flood resulted in extensive damage to 40% of the company's vehicles used for dispatching goods to customers; however, there have been no significant delays to customer deliveries. The company estimates the level of damage to the vehicles to be in excess of RM750,000. Only a minimal level of inventory, approximately RM35,000, was damaged. Bliz's insurance company has started to investigate the flood to assess the likelihood and level of payment, however, there are concerns the flood was started deliberately, and if true, would invalidate any insurance cover.

Event 2 – Inventory

On 18 February 2018, it was discovered that a large batch of the latest model of the hand gloves held in inventory at the year-end was defective, as the gloves contained too much chemical that caused itchiness to the hand. To date no sales of this latest hand gloves have been made. The cost of the defective batch of inventory is RM820,000 and the defects cannot be corrected. However, the scrapped hand gloves can be utilized as a raw material for an alternative hand glove brand at a value of RM45,000.

Required:

For each of the two subsequent events described above:

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i) Explain whether the financial statements require amendment.

(10 marks)

and

ii) Recommend audit procedures which should now be performed in order to form a conclusion on any required amendment.

(10 marks)

(Total : 20 marks)

Question 5

You are planning the audit of Megah Insurance Berhad for the year ended 31st December 2017. Megah which is based in Petaling Jaya has branches all over in Selangor, Johor, Perak and Sabah. Megah has only established its own internal audit department in year 2016 whereby previously, the internal audit function has been outsourced. For the purpose of planning the audit, you have a discussion with Puan Junaidah the chief audit executive of Megah. At the end of the meeting, Puan Junaidah highlighted her intention for the internal and external auditors to work together closely. She was thinking that if her idea is crystalized, the audit fee may fall and the board will appreciate her contribution to reducing Megah's costs thus, increase her reputation in the company. You have written the discussion with Puan Junaidah as follow:

- In the first few months of operation, the department reported to the chief financial officer (CFO), to enable it to gain a good understanding of the systems. Once this set-up phase was completed, the organisational structure of the internal audit department changed. The department now reports to the chief executive officer (CEO), who is also chairman of the board of directors.
- Puan Junaidah sets the department's work program after receiving feedback on risk areas from the CFO, the financial controllers of each state and the chair of the board. Over the past year, about 90% of the work program was achieved. This was because of a request from the board for the internal audit department to allocate resources to investigate a suspected travel claims fraud in Johor.
- Each month, Puan Junaidah prepares a report for the CEO, outlining the work planned and performed, and a summary of the results achieved. The CEO presents this report at the board's monthly meeting.

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- Puan Junaidah was appointed chief internal auditor in February 2015 after spending 3 years as the financial controller in Penang. Previously she was an audit manager at an external audit firm. She has five staff: three undertaking the professional accounting exam, an ex-public sector auditor and an assistant who is completing his accounting degree part time.
- Puan Junaidah has familiarised herself with the standards set by the Institute of Internal Auditors. Audit programs are being written as each audit is performed; these programs will be revised and updated as the department develops.
- Few of the financial controllers have been hostile to Puan Junaidah since the department was established. She suspects this is due to professional jealousy, because they had also applied for the chief internal auditor's position.
- Two of the six board members have yet to be convinced of the value of the internal audit department. They believe that its focus should be on improving operational efficiency, rather than on dealing with compliance matters. As a compromise, the CEO has agreed to ask Puan Junaidah to set aside 20% of the department's time to undertake a performance audit of the company's administrative procedures.
- Puan Junaidah and her team have visited each office this year (except Perth), examining the system and carrying out detailed transactions testing. Many minor control breaches were noted, although none likely to result in major errors or fraud. These breaches were reported in detail to the relevant financial controller.
- The board has been under enormous pressure over the past three months because an offer to buy the business has been received from an international financial company. Accordingly, the internal audit department's reports have received little attention in the monthly board meetings.

Required:

(a) According to International Standard On Auditing 610 (ISA 610) on using the work of internal auditors, explain the factors the external auditor will consider when evaluating the work of the internal auditor. (5 marks)

(b) Based on the above information and ISA 610, prepare the memo to your audit senior manager outlining your overall assessment of Megah Insurance Berhad's internal audit department. (12 marks)

(c) In your opinion, can the external auditor place reliance on the work of the internal audit department in the above scenario? Briefly explain your answer. (3marks)

(Total : 20 marks)

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